



Signed and Filed: November 14, 2007

A handwritten signature in dark ink, appearing to read "T. E. Carlson", is written over a horizontal line.

THOMAS E. CARLSON
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re)	Case No. 05-34008 TEC
)	
SDR CAPITAL MANAGEMENT, INC.,)	Chapter 7
)	
)	
Debtor.)	
)	
ANDREA A. WIRUM, Chapter 7 Trustee,)	
)	
)	
Plaintiff,)	
)	
vs.)	Adv. Proc. No. 07-3022 TC
)	
)	
JOHN O. WILSON, individually and as)	
Trustee of the Wilson Family Living)	
Trust,)	
)	
Defendant.)	

MEMORANDUM DECISION

This action was tried before the court on October 30 and November 1, 2007. Dennis D. Davis appeared for Plaintiff Trustee. John H. MacConaghy appeared for Defendant Wilson. For the reasons set forth below, I find for Defendant.

1 Debtor SDR Capital Management, Inc. (Debtor) provided
2 financial advice to investors. Defendant John Wilson (Wilson)
3 served as chief economist for the firm from January 1999 through
4 October 2001, and as a director from January 1999 through December
5 2001. As part of his compensation, Wilson received shares of
6 Debtor's stock. Debtor redeemed 205,240 of Wilson's shares in the
7 spring of 2002 for \$.62 per share, and redeemed Wilson's remaining
8 175,000 shares in the summer of 2003 for \$.52 per share.

9 Debtor filed a chapter 7 petition on October 11, 2005.
10 Trustee, contending that Debtor was insolvent at the time of each
11 of the payments to Wilson, and that the shares redeemed had no
12 value to Debtor, seeks to recover the payments to Wilson as
13 constructive fraudulent conveyances and as shareholder
14 distributions prohibited by California Corporations Code Section
15 506. Wilson contends that Debtor actually made money on the
16 transactions by reselling at \$1.00 per share the shares redeemed
17 from Wilson at \$.62 and \$.52 per share. I assume, without
18 deciding, that Debtor was insolvent at all times relevant.

19 The redemption of shares by an insolvent corporation generally
20 does not provide value to creditors of the corporation. Joshua
21 Slocum, Ltd. v. Boyle (In re Joshua Slocum, Ltd.), 103 B.R. 610,
22 618-19 (Bankr. E.D. Pa. 1989), aff'd 121 B.R. 442 (E.D. Pa. 1989);
23 Vadnais Lumber Supply, Inc. v. Byrne (In re Vadnais Lumber Supply,
24 Inc.), 100 B.R. 127, 136 (Bankr. D. Mass. 1989). This is so
25 because the redemption payment decreases corporate assets without
26 decreasing corporate debt. Furthermore, redemption generally does
27 not provide value to the corporation's creditors even when the
28 shares have value to a third party, because a corporation generally

1 can sell treasury shares without redeeming other shares. There is
2 no *per se* rule, however, and a court can find that retention of
3 shares does provide value to the corporation where it is a
4 necessary part of a broader transaction through which the
5 corporation obtains money or property. Corporate Jet Aviation,
6 Inc. v. Vantress (In re Corporate Jet Aviation, Inc.), 82 B.R. 619,
7 622-23 (N.D. Ga. 1987); aff'd 838 F.2d 1220 (11th Cir. 1988)
8 (table).

9 The present case warrants departure from the general rule.
10 The evidence shows that Debtor received reasonably equivalent value
11 for the funds paid to Wilson in redemption of his shares, because
12 that redemption was necessary to Debtor's sale of treasury shares
13 at a higher price.

14 Debtor would not have sold treasury shares to new investors
15 without redeeming shares previously issued. Debtor's shareholders
16 had agreed that the total number of shares issued or on which
17 options had been granted (the Outstanding Shares) would not exceed
18 11,600,000. The corporate records demonstrate that Debtor honored
19 this agreement. In March 2002, shortly before the first redemption
20 of Wilson's shares, there were exactly 11,600,000 Outstanding
21 Shares. Thereafter, each time Debtor issued shares, Debtor
22 redeemed a like number of shares at about the same time, so that
23 the Outstanding Shares never exceeded 11,600,000 for any extended
24 period of time.

25 The redemption of Wilson's shares was part of the means by
26 which Debtor sold treasury shares without breaching the limit on
27 Outstanding Shares. On April 30, 2002, Debtor recorded both the
28 redemption of 205,240 shares from Wilson, and the issuance of

1 196,905 shares to Butler, Russo and Young.¹ On April 25, 2003,
2 Debtor recorded the issuance of 175,000 shares to Lis, causing the
3 Outstanding Shares to exceed the agreed-upon limit by approximately
4 181,000. On June 10, 2003, Debtor redeemed Wilson's remaining
5 175,000 shares, and later redeemed additional shares from other
6 persons, to bring the number of Outstanding Shares within the limit
7 once again.²

8 Debtor made a profit both times that Debtor redeemed Wilson's
9 shares and sold treasury shares. At about the same time Debtor
10 redeemed 205,240 shares from Wilson for \$127,371, Debtor sold
11 196,905 shares to Butler, Russo and Young for \$196,905. Shortly
12 before Debtor redeemed 175,000 shares from Wilson for \$91,000,
13 Debtor sold 175,000 shares to Lis for \$175,000.

14 Based on the above, I determine that the redemption of
15 Wilson's shares and the sale of treasury shares should be combined
16 for the purpose of determining whether Debtor received value for
17 the shares redeemed. The Ninth Circuit used just this approach in
18 a similar situation, combining two transactions in holding that the
19 recipient of an alleged fraudulent transfer had paid reasonably
20

21 ¹ Debtor also recorded on April 30, 2002 the issuance of
22 598,065 shares to Daniel Warmenhoven for \$.57 per share, but
23 Debtor's March 7, 2003 "Cap Table" indicates that these shares had
24 been issued to Warmenhoven before that date, and thus should not be
25 paired with the redemption of Wilson's 205,240 shares.

26 ² There is conflicting evidence as to exactly when each
27 redemption and transfer of shares occurred. The letter
28 memorializing the agreement to buy or redeem shares has one date,
the related payment is made on a different date, and the transfer
is recorded on the Debtor's stock register on a third date.
Notwithstanding this variation, and the fact that in some instances
the formal decision to redeem occurred after the sale of treasury
shares, I find that the general pattern was to redeem shares as
necessary to keep Outstanding Shares within the 11,600,000 limit,
and that Debtor made the redemptions of Wilson's shares at issue
here with that intent.

1 equivalent value. Wyle v. C.H. Rider & Family (In re United Energy
2 Corp.), 944 F.2d 589 (9th Cir. 1991). "Bankruptcy courts are
3 courts of equity. As such, they possess the power to delve behind
4 the form of transactions and relationships to determine the
5 substance." Id. at 596. Thus, the bankruptcy court may combine
6 transactions that are "intimately intertwined." Id.; accord
7 Vantress, supra, 82 B.R. at 622-23.

8 Trustee contends that Debtor's sale of treasury shares should
9 be accorded no weight, because a subsequent SEC examination
10 disclosed numerous irregularities in the sale of those shares. The
11 SEC report stated that Debtor breached its fiduciary duty by
12 selling shares to existing clients for more than it paid, and that
13 Debtor should not have sold its shares to clients who maintained
14 conservative portfolios.

15 The SEC report does not justify disregarding the sale of
16 treasury shares in determining the value of the shares redeemed.
17 That Debtor should not have sold shares to its clients *at a profit*
18 does not suggest that the shares were not worth *at least what*
19 *Debtor paid Wilson*. Equally important, creditors suffered no harm
20 as a result of the problems noted by the SEC. None of the persons
21 who purchased the treasury shares ever asserted claims against
22 Debtor. Thus, the net result of the related redemption-sale
23 transactions was to increase Debtor's assets without increasing its
24 liabilities. Finally, to disregard the resale of shares for the
25 reasons urged by Trustee would not further the purpose of the
26 statutes under which Trustee asserts her claims (protecting
27 creditors against diminution of assets available to pay their
28 claims). Trustee's approach would have Wilson pay the estate for

1 securities violations that: (1) did not harm creditors of the
2 estate; (2) Wilson did not perpetrate; and (3) have never been
3 formally charged or established in any court.

4 I find that the redemption of Wilson's shares was "intimately
5 intertwined" with the sale of treasury stock at a higher price, and
6 that Debtor received fully equivalent value for the redemption
7 payments. Trustee cannot recover the transfers at issue as
8 constructive fraudulent conveyances, because Wilson provided
9 reasonably equivalent value for the money received. Cal. Civ. Code
10 § 3439.05. Trustee cannot recover the transfers at issue as
11 unlawful shareholder distributions, because Wilson provided
12 valuable consideration for the transfers. Cal. Corp. Code § 166.

13 It is not necessary to reach the other issues raised by the
14 parties.

15 Judgment will be entered for Wilson.

16 This memorandum decision constitutes the court's findings of
17 fact and conclusions of law.

18 ****END OF MEMORANDUM DECISION****
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